APPRAISAL BULLETIN

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"OLDEST OF THE ARTS AND NEWEST OF THE PROFESSIONS"

SINCE the dawn of civilization, and perhaps even before, men have been estimating the "value" of things. However, in appraising property, and particularly in appraising real estate today, it is not adequate to simply estimate the value of the property.

Appraising today involves a considerable amount of study in addition to a background of experience on the part of the appraiser which is seldom called for in other fields of endeavor. "Guesswork appraisals," if they ever were in order, are positively a thing of the past.

Modern appraising is a technical art which is becoming more and more of a science. However, by its very nature, it can never become an exact science. Appraising involves the mental measure of the economic significance of real properties in our existing economy, caused by the actions and transactions of human beings in the market place. The only basic evidence of this economic significance is prices as they are revealed in the actual markets of production, of use, and of exchange.

Needless to say, all theories, procedures, and processes must be merely measures and guides used by the appraiser to help him reach sound conclusions of economic significance. Unlike Pygmalion, who carved a ravishing statue of a woman and fell in love with it, the appraiser must never "fall in love with" any of his theories, procedures, or processes.

APPRAISERS' QUALIFICATIONS

Today's appraiser must be professional in the highest meaning of the word. The ethics, judgment, temperament, aptitude, knowledge, intelligence, training, and experience of the appraiser naturally affect the soundness and reasonableness of his appraisals.

We realize full well the high purpose and sincerity of the vast majority of those who are engaged in the appraisal profession. We are fully mindful of the gains already made in appraisal knowledge, technique, and procedure. Nevertheless, we are cognizant of the fact that much criticism is made of current appraisal practice by many people who are financially and otherwise interested in real estate. There are many who openly doubt the efficacy of appraisal theory, and there are some who claim that "one man's guess is as good as another's."

DIFFERENCES IN VALUATIONS

Most of the criticism which is directed at appraisers arises from the wide variation in the appraised values of the same properties. Oftentimes these valuations are publicly revealed when appraisals are made for legal purposes. Our courts have expressed amazement and deep concern, and our juries are baffled and confused by the excessive range of valuations given in testimony by so-called experts in the appraisal field. Attorneys in litigations involving real estate values seem to experience little difficulty in securing "qualified" appraisers to support with their testimony the widely divergent claims of either side of any case.

Unfortunately, these wide divergences of opinions are not confined to properties in litigation, but are existent also in appraising for nonlegal purposes. We have seen within the past two weeks a high-value appraisal amounting to more than 100% above the low-value appraisal of the same property, when the sole purpose of each of the appraisers was to reach a sound conclusion of value.

INCONSISTENT OPINIONS

Perhaps one of the greatest obstacles to the rendering of consistent opinions of value is the lack of a universally clear "language." It was Voltaire who told his friends: "If you wish to converse with me, define your terms." The American Institute of Real Estate Appraisers has gone a long way toward helping in this connection with its "Appraisal Terminology." But, the appraisal field is still plagued with many different meanings of words and phrases, and the problem is further complicated by the excess and oftentimes clumsy wording which has entered into our colloquial appraisal, economic, and legal phraseology.

The purpose for which an appraisal is made is of the utmost importance, if inconsistency is to be avoided. There are many people who believe that there is only one possible value for a given piece of property at a given instant of time. This, of course, is not the case. There is a reproduction value, which is the estimated contract-bid price of an assumed "lowest responsible bidder"; a reproduction-new-less-depreciation, or Present Worth, value; a sound value for loan purposes; a cadastral, or tax assessment, value; an insurance value; a sale, or market, value; a fair-market value, or "ought to be" market value; a capitalization of net income or investment value; a value for condemnation purposes; a liquidation value; etc. Surely the purposes for which any appraisal is made should be uppermost in the mind of the appraiser as he applies his appraisal methods and techniques in the conduct of his study.

ADVOCATE APPRAISING

It is sad to relate, but undoubtedly true, that one of the common causes of divergent opinions among appraisers has its basis in the unsuitability in ethics, in aptitude, and in temperament, of certain appraisers. These persons seemingly are unable to apply a neutral or judicial attitude, or to assume a disinterested and detached viewpoint in appraising property. Apparently some appraisers are swayed in their opinions by the result desired and become partisan or advocate-appraisers. Generally such men are strongly influenced in their opinions of value by the claims of the side for which they testify, by the amount of the loan desired, or by the desire to achieve some other predetermined result. We believe that the advocate type of appraiser is much more detrimental to the reputation of the ap-

praisal profession than the light-hearted type of man who might glibly render a curbstone opinion when a fee is involved or a friend is to be accommodated. We believe also that the advocate type appraiser is more dangerous to the reputation of the profession than even the chronic optimist or the chronic pessimist who consistently appraises too high or too low.

SOME BENCH MARKS

Some of the basic causes of unreasonable divergence of opinions as to value can be charged, as we have mentioned, against lack of personal qualification, lack of understanding of the purpose for which an appraisal is made, plus the inherent difficulties of "language." (Language which is not clear and is sometimes quite confusing; also, the use of terms in a technical sense which is contrary to the customary usage of these terms, and the use of words that are not subject to a single interpretation.)

It would be well at this time to investigate some acceptable "Bench Marks" which may be used to "test" the reasonableness of valuation opinions. The appraiser might well use the reproduction-cost-new to sight on in one direction, and market value, as determined from comparable open market sales, in the other direction. Without some such bench marks as these, an appraiser would be like a navigator sailing blindly without any checks on his various courses throughout a long journey.

We do not believe that the reconstruction-cost-new is necessarily the highest level above which value cannot go, but it is an excellent bench mark from which depreciation is measured. If the value of an income type of property, as determined from capitalization, results in a marked difference from either of these bench marks which is unreasonable in relation to the amount of depreciation estimated from observation and other calculations, then some doubt is raised as to the soundness of the appraised value so determined. When this happens, additional study is certainly indicated.

The capitalization process, which is considered the principal approach to the valuation of income properties, illustrates very clearly the many steps in which the appraiser must estimate many items, and for which he must exercise his good judgment without too much factual data to guide him.

Gross rental income, which is the price of the full use of the property under appraisement, can, of course, be capitalized directly, but the rate used must include the following estimates: (1) an allowance for vacancy and other income loss during the remaining future life; (2) the property expenses, including reserves for nonrecurring items; (3) the probable future patterns of net income; (4) the period in which the investment should be returned; (5) the rate of return on the investment; and (6) the completion of the capitalization process. If net income is capitalized directly, the capitalization rate used must still include estimates of the last four steps. Modern appraisal theory includes estimates for all six of these steps. While some of the items in step 2 are actual costs, such as taxes and insurance, we have witnessed differences in estimates of property expenses as great as 20%. The goal of the capitalization process is a capitalized sum which represents the value of the property as an investment. It is our belief that one of the principal causes of divergent valuations is the fact that this goal is often reached by the capitalization theory without the use of bench marks or controls determined from the realism of actual markets.

UNVERIFIED OPINIONS

In our opinion it is a fallacy to state that value as an investment is based upon the premises of intelligence, knowledge, and willingness of buyers and sellers and that the appraiser has the ability or knowledge to disregard investors' attitudes because in the appraiser's opinion investors in the market lack these qualities. (Again, Pygmalion falling in love with his own handiwork!)

There is a very real danger in all theoretical appraisal techniques in that there is a temptation for the appraiser to assume for himself some intelligence and knowledge which may differ radically from the investor's attitude under actual market conditions.

Any difference which the appraiser determines between his estimates of value and actual market value cannot be lightly ignored because of supposed vagaries of the market or lack of intelligence, knowledge, etc., on the part of investors. Such variations must be verified and substantiated by the appraiser by studies of existing market conditions and by studies of the different periods of the real estate cycle which portray the relationship of demand and supply.

In periods of shortage such as we have been experiencing these last several years, prices become out of balance with costs and rents, and markets become extremely active with prices generally above values. Such market conditions create excesses which experience tells us are followed by periods of liquidation when prices drop below values. (On very rare occasions such as existed in the Florida Land Boom, these excesses can reach proportions where hysteria and chaos rule. Under these conditions, which rarely exist, there is no measurable relationship between prices and values. Happily for all of us, the duration of such hysteria is usually short.) It is a proper function of the appraiser to study fundamentals and to know when unbalanced market conditions exist, to know the cause of any imbalance, and to estimate the variation of market value above or below the value as determined from the reproduction-cost-new-less-depreciation, or from the capitalized-income appraisal method.

It is almost certain that there will be differences of opinion of value even among appraisers who possess the qualifications of aptitude, knowledge, judgment, training, and experience.

We believe that among competent and qualified appraisers a spread of as much as 15% between the high and the low valuations of a given property under appraisement should not be considered unreasonable. From our observations and experience, the attainment of this range of accuracy would appear to be optimistic.